- A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.[16]

SEC disclosure requirements are somewhat more stringent than those of GAAP in that detailed property, plant, and equipment schedules and related schedules of accumulated depreciation, depletion, and amortization are required to be presented where such amounts are significant. Given these disclosure requirements, it is highly unlikely that a substantial change in the level of depreciation expense would go unnoticed by the reader of the financial statements. This is true not only for unregulated companies, but for carriers subject to the FCC's jurisdiction as well.

In summary, GAAP imposes constraints not only on the depreciable base, depreciation lives, and depreciation methods, but also on changes in depreciation methods and estimates. Further, it requires disclosure of the elements of depreciation accounting. In our view, these constraints operate simultaneously to preclude any carrier's ability to materially "manipulate" depreciation expense to achieve a predetermined earnings goal or to avoid sharing under the Commission's price cap regulations.

Qualitative Aspects of Depreciation Accounting

In 1980, the FASB issued its *Statement of Financial Accounting Concepts No. 2; Qualitative Characteristics of Accounting Information*, which further delineates the "tailoring criteria"[17] and standards that make accounting information useful to investors, creditors, lenders, government and the general public. The principal focus of this document is on which characteristics make accounting information useful, in particular for decision making by likely financial statement users. In assessing the usefulness of accounting information, the FASB

[16]AICPA, APB Opinion Number 12: Omnibus Opinion–1967, December 1967, section 5.

[17]A concept developed in Charles W. Lamden, D. L. Gerboth, and T. W. McRae, "Accounting for Depreciable Assets," New York: AICPA Accounting Research Monograph, number 1, 1975, chapter 3. As stated therein, "Tailoring criteria specify objectives and thereby assist in the selection of a suitable accounting method by prescribing the quality of the information that the method should produce."

developed a hierarchy of accounting information qualities based on the desirability of these qualities in a decision-making context. This hierarchy is reproduced in Attachment A to this document.

Because the primary purpose of financial statements is to provide information useful for decision making, and because accounting information that reflects these qualities is presumably more useful than information that does not, the FASB's hierarchy provides a useful framework for evaluating accounting information, especially in areas such as depreciation accounting. The remainder of this section will review the FASB's definitions and discussion of the major qualities and assess their import for depreciation accounting.

As previously noted, the primary decision-specific qualities identified by the FASB are relevance and reliability. Relevance is defined as "the capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events, or to confirm or correct prior expectations."[18] Principal components of relevant information are:

- *Feedback value* – the ability to confirm or corroborate decision makers' prior expectations.
- *Predictive value* – the value of information as an input into a predictive process but not directly as a prediction.
- *Timeliness* – making the information available to decision makers before it loses its capacity to influence decisions.

Extrapolating these concepts to the context of depreciation accounting implies, for example, that reported depreciation expense and reserve amounts should enable decision makers to determine, in a timely manner, the impact of capitalization and depreciation policies on current and future earnings potential, future investment requirements, and the integrity of the carrying

[18]FASB, Statement of Financial Accounting Concepts Number 2: Qualitative Characteristics of Accounting Information, May 1980, Glossary of Terms.

value of existing assets. If, for example, depreciation lives are too long, investors may underestimate a carrier's future capital requirements and overestimate its future earnings capabilities.

Of perhaps even greater significance in the context of depreciation accounting is the other primary quality—reliability. As defined by the FASB:

> The reliability of a measure rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the user, which comes through verification that it has that representational quality. . . .
>
> Accounting information is reliable to the extent that users can depend on it to represent the economic conditions or events that it purports to represent. . . . Reliability of accounting information stems from two characteristics that it's desirable to keep separate, representational faithfulness and verifiability. Neutrality of information also interacts with these two characteristics to affect its usefulness.[19]

The principal component characteristics that affect the reliability of accounting information, and their definitions, are:

- *Representational faithfulness* – "Correspondence or agreement between a measure or description of the phenomenon that it purports to represent (sometimes called validity)."
- *Neutrality* – "Absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior."

useful life in as accurate manner as possible. Thus, if a carrier's depreciable lives are consistently too short or too long (biased), then reported depreciation expense will not be a valid representation of the underlying economic reality, i.e., that the asset's economically useful life is longer or shorter than the period over which the asset's cost is being allocated.

Neutrality implies that "accounting information must report economic activity as faithfully as possible, without coloring the image it communicates for the purpose of influencing behavior in some particular direction."[21] In the context of depreciation, if an enterprise's management alters depreciation lives or methods in order to achieve predetermined results, such as manipulating reported earnings, then reported depreciation expense would not be a neutral measure and, as such, would fail to meet the requirement of reliability.

The FASB has recognized that reported depreciation amounts are among those least subject to verification by accounting measurements. With respect to verifiability, the FASB notes that there will be less consensus regarding the measurement of depreciable assets than measures of cash, receivables or inventories, because "there will be disagreements about depreciation methods to be used, predictions of asset lives and (if book values are based on historical cost) even which expenditures should be included in the investment base."[22]

Nevertheless, if a consistent pattern of gains or losses on disposal emerges for companies using unit depreciation, or if book depreciation reserves deviate significantly from theoretical depreciation reserves for companies using group depreciation practices, then some verification has occurred that the allocation of asset costs is not reliable.

The final desirable qualitative characteristic of accounting information is comparability. As the FASB has stated:

> Information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. The

[21] Ibid., paragraph 100.
[22] Ibid., paragraph 85.

> significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark.[23]

Simply put, accounting information is not used for decision-making purposes in a vacuum. Investors, lenders, and others compare an enterprise's financial performance with performances of other companies in the same industry, in other industries, and with the enterprise's own prior performances. The FASB has noted that a particularly "difficult kind of non-comparability to deal with is the kind that results when ill-chosen or incomplete data inputs are used to generate information that fails one test of reliability—it does not truly represent what it purports to represent."[24]

In the context of depreciation accounting, if the depreciation lives selected by an enterprise's management, or imposed by regulators, fail to reflect economically useful lives, financial statement users may be misled and not even realize it. This problem may be exacerbated if this state of affairs exists in an entire industry, so that intra-industry data may appear comparable, while inter-industry comparisons (more difficult to make) might reveal the unreliability of depreciation measures within the industry. Further, while auditors and financial statement users frequently test an enterprise's depreciation measures against other enterprises in the same industry, only rarely are benchmarks from outside the industry used, even in cases where similar types of assets are deployed.

In summary, the greater the degree that reported depreciation amounts are relevant, reliable and comparable, the more useful the presented information will be to financial statement users, including the FCC and state regulators. The failure to display such characteristics would cast doubt on the ability of financial statements to represent fairly the financial performance of the enterprise and could, in extreme instances, result in a violation of GAAP.

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[23]Ibid., paragraph 111.
[24]Ibid., paragraph 118.

Practical Accounting Considerations

As was addressed in an earlier section, the depreciation practices and policies of an enterprise are based on three principal decisions:

1. The definition of the depreciable base (cost or valuation).
2. Estimates of useful lives.
3. A method to allocate asset costs over their estimated lives.

Only the second item is being considered in CC Docket No. 92-296, and then only in the context of how useful lives are prescribed by the Commission, not how they are estimated for regulatory and financial reporting purposes. The FCC's *Rules and Regulations* define the methods used to determine the depreciable base (asset costs) in Part 32.2000, which is not at issue in this proceeding. In 1980, the Commission adopted equal life group (ELG) and remaining life depreciation methods.[25] The FCC has not proposed, at least specifically, to revisit these methods in this proceeding. ELG and remaining life are consistent with GAAP, which is generally permissive with regard to depreciation methods, allowing options ranging from group to unit depreciation, and from accelerated to decelerated methods. While GAAP permits a wide variety of depreciation methods, the vast majority of enterprises use a straight-line method, similar to that prescribed by the FCC.[26]

Additionally, remaining life is consistent with a need to allocate all of an asset's costs, if possible, over its economically useful life. ELG simply represents a disaggregation of a vintage group into finer groups with the same expected lives. Consequently, the remainder of this subsection will discuss the accounting literature on the estimation of useful lives.

The accounting literature has recognized that estimating useful lives is complex and incapable of precise resolution. As one accounting text has commented:

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[25]Amendment of Part 31 to Permit ELG, Report and Order, 83 FCC 2d 267, 1980; Reconsideration, 87 FCC 2d 916, 1981; Supplemented, 87 FCC 2d 1112, 1981.

[26]Lambden et al., pp. 18-20; Ernst & Whinney (now Ernst & Young), Review of Depreciation Policies and Procedures in Selected Industries, 1986, section 2.

> Despite the abundance of data from experience, estimating service lives is the most difficult task in the entire depreciation calculation. Making proper allowances for obsolescence is particularly difficult, because obsolescence results for the most part from forces external to the firm. Unless the estimator professes prophetic powers, it is likely that the estimates will prove to be incorrect. For this reason, the estimates of useful service life of important assets or groups of assets should be reconsidered every few years. Estimating the 'true' economic life of an asset with a long life as required for financial reporting is hard.[27]

Given the recognition of the difficulty of estimating useful lives, the literature nevertheless attempts to provide some guidance for both accountants and auditors in this regard. One major text identifies the causes of depreciation as:

> Physical Factors
>
> - Wear and tear from operation
> - Action of time and other elements
> - Deterioration and decay
>
> Functional Factors
>
> - Inadequacy (asset is not capable of providing the level of service or output required in the business)
> - Supercession and obsolescence (where supercession means that new technologies supersede the value of older technologies and obsolescence, the slightly broader term, subsumes the other attributes as well as suggesting the outmoding of the product or service produced).[28]

In amplifying the application of these factors to determine depreciable lives, it is recognized that

> those factors that operate more or less continuously are given recognition in depreciation accounting, whereas sudden and unexpected factors such as storms, floods, sudden changes in demand and radical outmoding of the asset must be accorded special treatment with respect to the fixed assets involved.[29]

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[27]Sidney Davidson, "Depreciation," in Sidney Davidson and Roman Weil, eds., Handbook of Modern Accounting, New York: McGraw-Hill, 1983, chapter 20, pp. 6 and 7.
[28]Glen A. Welsch, Charles T. Zlatkovich, and John A. White, Intermediate Accounting, Illinois: Richard D. Irwin, Inc., 1976, pp. 545-6.
[29]Ibid., p. 546.

Thus, application of these factors recognizes their constancy and predictability in affecting useful lives, not acts of God, or sudden changes in the market, or technological outlook.

The most comprehensive set of criteria or standards developed for evaluating estimates of useful life was set out in an Accounting Research Monograph in 1975.[30] These criteria or standards are:

1. The estimate of 'useful life' encompasses that span of time beginning after an asset is ready for use and begins to benefit the company significantly or when it's ability to benefit the company begins to expire, and ending when the asset no longer benefits the company significantly or when its ability to benefit the company expires.

2. The estimate does not reflect unpredictable events (causalities other than routine and predictable hazards, sudden obsolescence resulting from revolutionary changes in technology, losses from unexpected government action, and similar events) as events contributing to the end of useful life.

3. The estimate recognizes in a reasonably adequate manner:

   - The pattern of anticipated use.
   - The predictable effects of obsolescence.
   - The effects of wear and tear from use or the passage of time.
   - The level of maintenance that a prudent person would consider normal for the asset or class of assets.

4. The estimate is consistent with reliable past average lives (determined on the basis of competent historical data and, if feasible, by the use of statistical techniques) for the asset or class of assets in:

   a. The industry: If the use of the asset or class of assets is unique to the industry or the circumstances of use in that industry have unique characteristics.

   b. The circumstances of use: If the circumstances of use of the asset or class of assets have characteristics that are common to more than one industry.

   c. The individual company: If the use of the asset or class of assets is unique to a company or the circumstances of use in the company have unique characteristics.

[30]Lambden et al., pp. 76-77.

5. The estimate is supported by other competent evidence, such as engineering studies, if competent historical evidence is not available.

The reliance on such empirical tests in developing depreciation practices would be fully responsive to GAAP and would achieve the desirable qualitative characteristics of accounting information enunciated by the FASB.

The accounting guidelines for estimating depreciable lives essentially rely on fully informed and expert judgment on the part of practitioners. The factors identified in this Monograph are, at least in substance, quite similar to those used by the FCC in establishing depreciation rates. The principal differences between telecommunications carriers and unregulated firms are the greater reliance on expert judgment than engineering or mortality studies in unregulated industries and the enhanced scrutiny of depreciation, and attendant effort devoted to it, in regulated industries.[31] Further, it is interesting to note that, as a practical matter in unregulated industries, specific depreciation practices of companies are rarely a controversial item.

Institutional Structures, Responsibilities, and Financial Reporting

Previous sections summarized the purpose of financial reporting, described the constraints GAAP imposes on reported depreciation amounts, and identified the disclosure requirements related to this expense. In the section that follows, we review the institutional framework employed and relied on by users of the financial statements to ensure the integrity of financial information. The discussion that follows relates to all significant financial information, including depreciation expense since it is such a major component of all regulated carriers' total operating expenses.

This framework essentially consists of a series of checks and balances established by the roles and responsibilities of management, the board of directors as represented by its audit

[31]Ernst & Whinney, section 2.

committee, the internal auditor, and the independent auditor. Because of the significance of depreciation to regulated carriers, we also describe the audit procedures applicable to depreciation and to obtaining assurance that the estimated service lives employed to calculate depreciation expense are reasonable.

Management's Role and Responsibilities in the Preparation of Financial Statements

Management is responsible for the integrity of the financial statements of the company. This important responsibility is explicitly recognized in the Report of Management contained in annual reports, including those of all price cap carriers subject to the Commission's jurisidiction. In the Report, management represents that the financial statements have been prepared in accordance with GAAP and states that the integrity and objectivity of the data in the financial statements (including estimates and judgments relating to matters not concluded by year-end) are its responsibility. The Report also informs the user that the financial statements have been audited by independent auditors and that management has made available to the independent auditors all of the company's financial records and related data. Management acknowledges that all representations made to the independent auditor were valid and appropriate.

The Report acknowledges that management has established and maintains a system of internal accounting controls to provide reasonable assurance of the integrity and reliability of the financial statements, the protection of assets, and the prevention and detection of fraudulent financial reporting.[32] Other representations of management include assurances that the objectivity and integrity of financial data are maintained by carefully selecting managers, by organizational arrangements that appropriately divide responsibility and by communications programs designed to assure that policies, standards, and managerial authorities are understood throughout the organization. The user is also informed that management continually monitors the system of internal accounting controls for compliance and that the company maintains an

[32]The concept of reasonable assurance recognizes that the costs of an internal accounting controls system should not exceed, in management's judgment, the benefits derived.

internal auditing program that independently assesses the effectiveness of the internal accounting controls and recommends improvements.[33]

For management (including management of the LECs) to provide these assurances, the financial reporting process must include procedures and controls which, among other things, are designed to:

- Promote a control environment and corporate attitude that support appropriate business practices;.
- Identify and address areas of financial risk on a timely basis;
- Ensure that the company's assets are safeguarded in a prudent, cost effective manner;
- Result in all, and only, properly authorized transactions being recorded; and
- Minimize the risk of fraudulent financial reporting.

While it is the responsibility of the financial personnel to carry out these procedures and perform many of the control functions in the financial reporting process, senior management is responsible for ensuring that the policies and procedures which govern the process are adequate and that they are functioning and effective.

In addition to the preceding representations and assurances, and as an additional safeguard, the SEC requires that key management personnel and a majority of the board of directors sign the annual report 10(k) filed with the SEC. Similarly, the FCC requires that a subject carrier's responsible accounting officer sign the annual report Form M which is filed with the Commission.

The knowing and willful communication of false and fraudulent financial information by management can result in the termination of employment, lawsuits against the individual(s) or corporation, fines, and imprisonment. Clearly these are strong deterrents to fraudulent financial reporting, including the potential manipulation of depreciation expense to achieve earnings goals.

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[33]For examples of the precise language contained in the Report of Management, refer to the most recent Annual Report of any subject carrier listed on the New York Stock Exchange.

The Role and Responsibilities of the Audit Committee

Users of financial statements, including the FCC, need not rely exclusively on the assurances and representations of management. They may also rely on the company's audit committee. The SEC has long recognized the importance and value of audit committees. As far back as 1940, the SEC recommended that publicly traded companies create audit committees. And in 1978, the New York Stock Exchange mandated that listed companies have audit committees comprised of outside directors.

Overseeing the financial reporting process is one of the most important responsibilities of the audit committee. With this in mind, the committee will typically:

Review and recommend to the directors the independent auditors to be selected to audit the financial statements of the company.

Meet with the independent auditors and financial management to review the scope of the proposed audit for the current year and the audit procedures to be utilized, and at the conclusion review the audit, including any comments or recommendations of the independent auditors.

Review with the independent auditors, the company's internal auditor, and financial and accounting personnel, the adequacy and effectiveness of the accounting and financial controls, and elicit any recommendations for the improvement of internal control procedures or particular areas where new or more detailed controls or procedures are desirable.

Review the internal audit function including independence and authority of its reporting obligations, the proposed audit plans for the coming year, and the coordination of such plans with the independent auditors

Review summaries of findings from internal audits and progress reports on the proposed internal audit plan, with explanations for any deviations from the original plan.

Review the financial statements contained in the annual report to shareholders with management and the independent auditors to determine that the independent auditors are satisfied with the disclosure and content of the financial statements to be presented to the shareholders. Any changes in accounting principles are also reviewed.

Provide sufficient opportunity for the internal and independent auditors to meet with the members of the audit committee without members of management

present. Among items discussed in these meetings are the independent auditors' evaluation of the company's financial, accounting, and auditing personnel, and the cooperation that the independent auditors received during the course of the audit.

Review accounting and financial human resources and succession planning within the company.

Submit minutes of all meetings of the audit committee to, or discuss the matters discussed at each committee meeting with, the board of directors.

Investigate any matters brought to its attention within the scope of its duties.

Maintaining a system of internal controls has always been a sound business practice. However, as a result of the Foreign Corrupt Practices Act of 1977 (the Act), public companies and their officers, directors, and employees became subject to potential sanctions under federal securities laws for not having an adequate system of internal control or accurate accounting records. The Act increased board members' awareness of internal control needs, and audit committees have typically represented the full board in pursuing this concern.

Audit committee members are not in the position to determine if the internal controls over the financial reporting process are functioning properly. They must rely on others to make this determination. Usually, this means asking questions of those directly responsible for internal controls—financial management. Management can provide background information on the internal controls, but audit committees also need **independent** assurances. They obtain these assurances from the internal auditors and the independent auditors.

The Role and Responsibilities of the Internal Auditor

The internal audit function is another important safeguard to ensure the integrity of financial information and compliance with GAAP. The internal auditor provides assurance to management and the audit committee about the adequacy of the system of internal control. Internal auditors usually participate in the annual independent audit and may also evaluate compliance with corporate policies, as well as conduct operational audits. The typical activities and responsibilities of internal auditors include:

- Verification of account balances;
- Review of internal control systems, tests of compliance with internal controls, and suggestions on matters for improvement;
- Review of compliance with the company's policies and procedures;
- Recommendations concerning operational improvements;
- Performance of special examinations such as defalcations, conflicts of interest, and compliance with the corporate code of conduct; and
- Coordination with the independent auditors on the annual audit.

The importance placed on these activities by internal auditors will vary from one company to the next. In effective organizations, the director of internal audit has direct, unrestricted access to the audit committee. As with the independent auditor, the audit committee reviews the planned scope of the internal auditors' work, the results of their work, and management's actions in response their recommendations.

The Role and Responsibilities of the Independent Auditor

In addition to the representations made by management, the important oversight role provided by the audit committee, and the efforts of the internal audit department, users of financial statements receive an additional level of assurance from the company's independent auditors. The independent auditors examine the financial statements of the carriers to determine whether, in their opinion, they present fairly, in all material respects, the company's financial position, the results of operations, and cash flows in conformity with generally accepted accounting principles.

Independent auditors must conduct their examinations of financial statements in accordance with generally accepted auditing standards. These standards are different than auditing procedures

> in that procedures relate to acts to be performed, whereas standards deal with measures of the quality of performance of those acts and the objectives to be

> attained by the use of the procedures undertaken. Auditing standards as distinct from auditing procedures thus concern themselves not only with the auditor's professional qualities but also with the judgment exercised by the auditor in the performance of the examination and in the report.[34]

Generally accepted auditing standards require that the auditor plan and perform the audit to obtain reasonable assurance about the financial statements are free from material misstatement.

The Auditing Standards Board of the AICPA adopted a number of auditing standards that became effective in 1990 and require substantial communications between the independent auditor and audit committee. These are important standards that should be recognized when considering the potential incentive to manipulate earnings, in general, or specifically by "gaming" the regulatory process through the use of arbitrary or unreasonable depreciation rates.

Those standards particularly relevant for this docket include the Statement of Auditing Standards 53, *"The Auditor's Responsibility to Detect and Report Errors and Irregularities,"* (SAS 53), and the Statement of Auditing Standards 61, *"Communications with Audit Committees"* (SAS 61). SAS 53 requires that independent auditors communicate to audit committees any irregularities which the auditor becomes aware of unless those irregularities are clearly inconsequential. The auditor must design the audit to obtain reasonable assurance that errors and irregularities material to the financial statements will be detected. This would include those unsubstantiated changes to depreciation rates and accruals that are material in nature.

SAS 61 requires the independent auditor to determine that certain matters related to the conduct of an audit are communicated to the audit committee. Those requirements that have particular relevance with respect to depreciation accounting, i.e., estimated lives and depreciation methods and changes to those lives and methods, are listed below.

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[34]R. K. Mautz, "Accounting Concepts and Principles and Auditing Standards and Opinions," Handbook of Modern Accounting, 3rd ed., Sidney Davidson and Roman L. Weil, eds., New York: McGraw-Hill, 1983, sections 1-23.

Significant accounting policies

Initial selection of and changes in significant accounting policies

Methods used to account for significant unusual transactions

Effect of significant accounting policies in controversial or emerging areas

Management judgments and accounting estimates

Process used by management in formulating particularly sensitive accounting estimates

Basis for independent auditor's conclusions regarding the reasonableness of those estimates

Disagreements with management, whether or not satisfactorily resolved, on

Specific transactions and events

Scope of the audit

Disclosures to be included in the financial statements

Wording of the auditor's report

Major issues discusses with management prior to retention

Application of accounting principles

Professional reputation for independence, honesty, and integrity is the most valued asset of the individual independent auditor and his or her firm. And, as previously stated, independent auditors are required to follow generally accepted auditing standards. The penalties for failing to comply with these standards are severe. They can include loss of the client, investigations by the ethics authorities representing the AICPA and state agencies, loss of the auditor's CPA license, suspension or revocation of the rights to practice before the SEC, and fines and imprisonment if it is established that the auditor was engaged in fraudulent financial reporting.

Audit Considerations Regarding Depreciation

The preceding section described the role and responsibilities of the independent auditor as they relate to general purpose financial reporting. In this section, we discuss the specific audit considerations regarding depreciation.

Audit procedures applicable to depreciation test a variety of elements in evaluating depreciation charges. These include:

- Reasonableness and consistency of methods, i.e., are they systematic and rational—straight-line versus accelerated or decelerated depreciation; treatment of gains and losses; good cause for changing methods or estimates.
- Reasonableness and consistency of calculations—accuracy.
- Reasonableness of estimated lives or other bases for allocating costs—for example, lives of existing assets are compared to those for similar new assets; a pattern of large gains or losses on disposal (when unit depreciation is used) or a significant depreciation reserve deficiency emerges (when group depreciation is used), indicating inaccurate life estimates. Other underlying factors affecting lives are evaluated, e.g., through reviewing publicly announced plans to upgrade the network and comparing those announcements to construction programs and budgets. The reasonableness of the methods employed to estimate lives is reviewed and confirmation that these procedures were followed is obtained. The competency and continuity of the company's personnel engaged in performing the estimates is evaluated. Manufacturers' views regarding anticipated service lives, e. g., digital switching, are

risk is the likelihood that the auditor may unknowingly fail to appropriately modify his or her opinion on financial statements that are materially misstated. Audit risk involves three factors:

1. Inherent risk relates to the susceptibility of an account balance to material misstatement (irrespective of financial controls).
2. Control risk arises from potential internal control failures.
3. Detection risk is the risk that auditing procedures will lead an auditor to conclude that misstatements that could be material do not exist when they do, in fact, exist.

Depreciation amounts are subject to both inherent risk and detection risk because material misstatement could occur, especially in times of rapid technological or market change. The complexity of useful life estimation creates detection risks. On the other hand, control risks are germane only to specific individual companies. Among the factors deemed to create inherent risks related to property, plant, and equipment balances that will result in a high level of audit emphasis are:

- Significant amounts of property, plant and equipment are constructed in-house.
- The volume of property, plant, and equipment additions, replacements, trade-ins, and disposals is high.
- The quantity of property, plant and equipment is high.
- The level of movement of plant and equipment changes.
- Property, plant and equipment is susceptible to technological innovations or regulatory factors that will affect useful lives.
- Extensive retooling is required for changes in products and/or production processes.
- Plant expansion or modernization is occurring.

Although FCC prescriptions of depreciation accounting, in combination with *FAS 71: Accounting for the Effects of Certain Types of Regulation*, may have reduced the level of effort that carriers' auditors devote to testing depreciation measurements, under a new FCC prescription process, auditors of telecommunications carriers would likely devote extensive

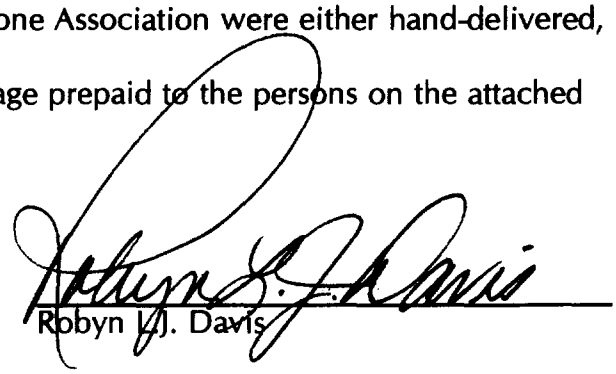
resources to auditing the depreciation accounting process and results. This is also recognized by the Commission in this docket when it stated,

> . . . with a diminished Commission role in determining depreciation expense levels, we believe greater responsibility will be placed on the carriers and their independent auditors to impose the internal controls and review procedures that are necessary to ensure that reported depreciation expense is reasonable.[35]

Generally, calculated depreciation expense is treated as a non-routine data process in an audit. That is, these are accounting processes applied only periodically, in conjunction with the preparation of financial statements. In this context, analytical review procedures (ARPs) become an important audit evaluation method. ARPs are evaluations of financial information made by

CERTIFICATE OF SERVICE

I, Robyn L.J. Davis, do certify that on April 13, 1993 copies of the foregoing Reply Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.



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